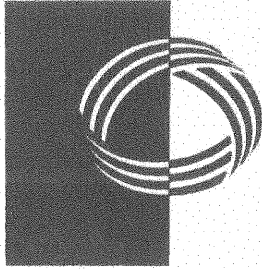


Financial Statements and Report of
Independent Certified Public Accountants



**GEORGIA DEPARTMENT OF
COMMUNITY HEALTH**

June 30, 2005

BKR Metcalf Davis

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CERTIFIED PUBLIC ACCOUNTING FIRMS

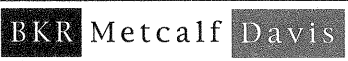
**Mauldin
& Jenkins**

FINANCIAL STATEMENTS
GEORGIA DEPARTMENT OF COMMUNITY HEALTH
JUNE 30, 2005

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INDEPENDENT AUDITORS' REPORT



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Independent Auditors' Report

The Honorable Tim Burgess, Commissioner
State of Georgia's Department of Community Health

We have audited the accompanying financial statements of the governmental activities, the business-type activities, and each major fund of the **State of Georgia's Department of Community Health** (hereinafter referred to as the "**Department of Community Health**") as of and for the year ended June 30, 2005, which collectively comprise the **Department of Community Health's** basic financial statements as listed in the table of contents. These financial statements are the responsibility of the **Department of Community Health's** management. Our responsibility is to express opinions on these financial statements based on our audit.

As discussed in Note 1, the financial statements of the **Department of Community Health** are intended to present the financial position, and the changes in financial position and cash flows, where applicable, of only that portion of the governmental activities, the business-type activities, and each major fund of the State of Georgia that is attributable to the transactions of the **Department of Community Health**. They do not purport to, and do not, present fairly the financial position of the State of Georgia as of June 30, 2005, and the changes in its financial position and its cash flows, where applicable, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the

financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, and each major fund of the **Department of Community Health**, as of June 30, 2005, and the respective changes in financial position, and where applicable, cash flows, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 8, 2005 on our consideration of the **Department of Community Health's** internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis and the budgetary comparison information on pages 3 through 15, and pages 39 through 42, respectively, are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

BKR Metcalf Davis

Madden & Jensen, LLC

Atlanta, Georgia
November 8, 2005

MANAGEMENT'S DISCUSSION AND ANALYSIS

Department of Community Health

MANAGEMENT'S DISCUSSION AND ANALYSIS

JUNE 30, 2005

As management of the Georgia Department of Community Health (the "Department"), we offer readers of the Department's financial statements this narrative overview and analysis of the financial activities of the Department for the fiscal year ended June 30, 2005.

Financial Highlights

- As stated in the Department's prior year report, the Department implemented a new claims payment system for the administration of healthcare benefits for Medicaid and PeachCare for Kids on April 1, 2003. Because the new system was initially unable to perform accurate claims processing in a timely manner, the Department made provider-specific, interim payments. At the end of fiscal year 2003, the accounts receivable balance resulting from these payments was \$465,591,654.87. Substantial progress in recoveries during fiscal years 2004 and 2005 resulted in a decrease in accounts receivable for prospective payments of \$418,736,922.23 leaving an outstanding balance at June 30, 2005 of \$46,854,732.64. This also resulted in a decrease in federal deferred revenue from \$130,448,671.97 to \$45,025,115.09.
- During fiscal year 2005, Medicaid and PeachCare for Kids claims payment errors resulted from known system defects not corrected prior to the end of fiscal year 2005.
 - In order to produce fairly represented financial statements, adjustments were made to the Governmental Fund's asset and liability totals to reflect estimated overpayments and underpayments, respectively. Estimates were determined by management with the assistance of an independent CPA firm via an agreed-upon procedures engagement and conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. With a 95 percent confidence level at June 30, 2005, estimated additional accounts receivable equal \$19,557,500.00 with a \$2,292,400.00 margin of error (plus or minus). Estimated additional liabilities equal \$5,154,500.00 with a \$1,122,300.00 margin of error (plus or minus).
 - The estimation process included the identification of system defects causing payment errors. Each system defect known to have resulted in a payment error has been evaluated and a work plan for correction has been established. The Department will determine which effected claims to reprocess once the correction has been implemented.
 - The point estimates used in this study were also used to adjust the incurred but not reported claims liability total at June 30, 2005 which increased from \$901,100,000.00 to \$957,200,000.00, or 6.2 percent, from the preceding year.
- The assets of the Department exceeded its liabilities at the close of the most recent fiscal year by \$104,532,021.31 (net assets). Of this amount, \$87,314,801.45 (unrestricted net assets) may be used to meet the Department's ongoing obligations to citizens and creditors.

Department of Community Health

- At June 30, 2005, the Department's Governmental Fund reported an ending fund balance of \$15,958,593.99, an increase in fund balance of \$30,183,797.82 from the prior year. Collection of hospital cost settlements and increased drug rebate collections were major contributors to the increased fund balance.
- As budgeted, during fiscal year 2005, the Department's Enterprise Fund experienced an operating loss of approximately \$253 million. For fiscal year 2006, proprietary revenue has been budgeted to increase as a result of additional State appropriations to support employer contributions. Collections from payroll and direct employer billing are budgeted to increase by \$237,705,686.00. Additional revenue increases will come from monthly surcharges paid by the employees. A \$40.00 per month tobacco surcharge has been added to the monthly premium if the employee or covered dependents have used tobacco products in the previous 12 months. A \$30.00 per month spousal surcharge has been added to the monthly premium if the employee elected to cover the spouse and the spouse is eligible for coverage through his/her employment but chose not to take it. These additional revenue sources, along with the implementation of various expenditure controls result in annual expenditures budgeted close to breakeven.
- During fiscal year 2005, the Department entered into a "compromise agreement" with its fiscal agent, Affiliated Computer Services, Inc. ("ACS"). Significant financial transactions occurred at the execution of the compromise agreement, and they are as follows:
 1. Department paid ACS \$9,000,000.00 for developmental invoices.
 2. Department paid ACS \$8,502,498.51 as settlement of a dispute over withheld liquidated damages.
 3. Department deposited \$11,840,196.00 into a custodial account at the Office of Treasury and Fiscal Services ("OTFS") pending completion of all developmental services. As of June 30, 2005, no payments have been made from this account. A corresponding liability in the amount of the deposit has been reported in accounts payable and accrued liabilities.
 4. ACS paid the Department \$10,000,000.00 and agreed the Department should retain \$7,200,000.00 of the liquidated damages previously assessed.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Department's basic financial statements. The Department's basic financial statements are comprised of three components: 1) department-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements.

Department of Community Health

Department-wide financial statements. The *department-wide financial statements* are designed to provide readers with a broad overview of the Department's finances, in a manner similar to a private-sector business.

The *statement of net assets* presents information on all of the Department's assets and liabilities, with the difference between the two reported as *net assets*. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Department is improving or deteriorating.

The *statement of activities* presents information showing how the Department's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, *regardless of the timing of related cash flows*. Therefore, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., earned but unused vacation leave).

Both of the department-wide financial statements distinguish functions of the Department that are principally supported by taxes and intergovernmental revenues (*governmental activities*) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (*business-type activities*). The department-wide financial statements can be found on pages 16 and 17 of this report.

Fund financial statements. A *fund* is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Department, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the Department can be divided into two categories: Governmental Funds and Proprietary Funds.

Governmental Funds are used to account for essentially the same functions reported as *governmental activities* in the government-wide financial statements. However, unlike the government-wide financial statements, Governmental Fund financial statements focus on *near-term inflows and outflows of spendable resources*, as well as *balances of spendable resources* available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

Because the Governmental Fund's focus is narrower than that of the department-wide financial statements, it is useful to compare the information presented for *Governmental Funds* with similar information presented for *governmental activities* in the department-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the Governmental Fund balance sheet and the Governmental Fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between *Governmental Funds* and *governmental activities*. The Department adopts an annual appropriated budget utilizing a budgetary basis of accounting that is not in accordance with generally accepted accounting principles ("GAAP"). A budgetary comparison schedule

Department of Community Health

MANAGEMENT'S DISCUSSION AND ANALYSIS

JUNE 30, 2005

has been provided to demonstrate compliance with this budget following the notes in the required supplementary information. The basic Governmental Fund financial statements can be found on pages 18, 19 and 20 of this report.

Proprietary Funds are used to account for a government's *business-type activities*. Although governmental accounting principles recognize two types of proprietary funds (enterprise and internal service funds), the Department only maintains an Enterprise Fund. The *Enterprise Fund* is used to report the same functions presented as *business-type activities* in the department-wide financial statements. The Department uses Enterprise Funds to account for its State Health Benefit Plan financial activities. The basic Proprietary Fund financial statements can be found on pages 21, 22 and 23 of this report.

Notes to the financial statements. The notes provide additional information that is essential to a full understanding of the data provided in the Department-wide and fund financial statements. The notes to the financial statements can be found on pages 24-38 of this report.

Department-Wide Financial Analysis

Net assets. As noted earlier, net assets may serve over time as a useful indicator of a government's economic position. In the case of the Department, assets exceeded liabilities by \$104,532,021.31. The following table presents a condensed statement of net assets as of June 30, 2005 and June 30, 2004.

	Governmental Activities June 30, 2005	Governmental Activities June 30, 2004	Business - Type Activities June 30, 2005	Business - Type Activities June 30, 2004	Total	
					June 30, 2005	June 30, 2004
Current Assets:						
Cash, Cash Equivalents and Investments	\$ 27,878,551.45	\$ 37,617,496.86	\$ 27,916,609.57	\$ 210,050,167.18	\$ 55,795,161.02	\$ 247,667,664.04
Receivables (Net of Allowances for Uncollectibles)	1,141,989,046.71	1,106,662,798.14	47,898,745.27	42,001,543.77	1,189,887,791.98	1,148,664,341.91
	\$ 1,169,867,598.16	\$ 1,144,280,295.00	\$ 75,815,354.84	\$ 252,051,710.95	\$ 1,245,682,953.00	\$ 1,396,332,005.95
Noncurrent Assets:						
Capital Assets, Net	738,262.26	259,422.80	-	-	738,262.26	259,422.80
Investments	-	-	266,601,178.55	310,105,831.05	266,601,178.55	310,105,831.05
	\$ 738,262.26	\$ 259,422.80	\$ 266,601,178.55	\$ 310,105,831.05	\$ 267,339,440.81	\$ 310,365,253.85
	\$ 1,170,605,860.42	\$ 1,144,539,717.80	\$ 342,416,533.39	\$ 562,157,542.00	\$ 1,513,022,393.81	\$ 1,706,697,259.80
Current Liabilities:						
Cash Overdraft	\$ 56,438,708.03	\$ 19,496,359.21	\$ -	\$ -	\$ 56,438,708.03	\$ 19,496,359.21
Accounts Payable and Other Accruals	95,227,734.98	107,454,011.85	14,409,331.45	12,743,650.73	109,637,066.43	120,197,662.58
Benefits Payable	957,200,000.00	901,100,000.00	169,380,000.00	154,822,000.00	1,126,580,000.00	1,055,922,000.00
Deferred Federal Revenue	45,025,115.09	130,448,671.97	-	-	45,025,115.09	130,448,671.97
Other Current Liabilities	14,747,321.22	14,583,244.75	54,768,006.32	47,998,240.35	69,515,327.54	62,581,485.10
	\$ 1,168,638,879.32	\$ 1,173,082,287.78	\$ 238,557,337.77	\$ 215,563,891.08	\$ 1,407,196,217.09	\$ 1,388,646,178.86
Noncurrent Liabilities	1,184,748.61	14,884,760.34	109,406.80	100,331.93	1,294,155.41	14,985,092.27
	\$ 1,169,823,627.93	\$ 1,187,967,048.12	\$ 238,666,744.57	\$ 215,664,223.01	\$ 1,408,490,372.50	\$ 1,403,631,271.13
Net Assets:						
Invested in Capital Assets, Net of Related Debt	\$ 738,262.26	\$ 259,422.80	\$ -	\$ -	\$ 738,262.26	\$ 259,422.80
Restricted	16,478,957.60	18,275,818.36	-	-	16,478,957.60	18,275,818.36
Unrestricted	(16,434,987.37)	(61,962,571.48)	103,749,788.82	346,493,318.99	87,314,801.45	284,530,747.51
	\$ 782,232.49	\$ (43,427,330.32)	\$ 103,749,788.82	\$ 346,493,318.99	\$ 104,532,021.31	\$ 303,065,988.67

Department of Community Health

MANAGEMENT'S DISCUSSION AND ANALYSIS

JUNE 30, 2005

Highlights. Assets decreased by 11.35 percent. This decrease is due primarily to the use of existing cash to fund the shortage in operating revenues in the Proprietary Fund (business-type activities) as mentioned previously under "Financial Highlights."

A bank entity settlement payment of \$267,419,071.00 occurred on June 30, 2005. The remaining cash overdraft total represents outstanding checks and electronic funds transfers ("EFTs") not yet funded as of June 30, 2005. Funding occurs as checks and EFTs clear the bank.

The largest portion of the Department's net assets reflects total receivables amounting to \$1,189,887,791.98 offset by benefits payable totaling \$1,126,580,000.00. These receivables represent the primary means of funding the respective liabilities. While there was only a small increase in receivables (3.6 percent), there was a 6.7 percent increase in benefits payable. This growth is a reflection of the growth experienced in net payments from fiscal year 2004 to fiscal year 2005. An explanation of the growth in net payments by fund type is included later in the report.

Changes in net assets. The Department's total revenue for the fiscal year ended June 30, 2005 was \$9,881,141,281.51. The total cost of all programs and services was \$10,079,675,248.87. The following table presents a summary of the changes in net assets for the fiscal years ended June 30, 2005 and 2004.

	Governmental Activities June 30, 2005	Governmental Activities June 30, 2004	Business - Type Activities June 30, 2005	Business - Type Activities June 30, 2004	Total	
					June 30, 2005	June 30, 2004
Revenues:						
Program Revenues:						
Charges for Services	\$ 293,728,108.00	\$ 288,838,452.00	\$ 1,805,784,104.84	\$ 1,729,565,583.41	\$ 2,099,512,212.84	\$ 2,018,404,035.41
Operating Grants	4,782,057,993.83	4,850,467,058.88	-	-	4,782,057,993.83	4,850,467,058.88
General Revenues:						
State Appropriation	2,001,995,778.00	1,887,221,940.00	33,956,708.00	34,000,000.00	2,035,952,486.00	1,921,221,940.00
Interest	59,990.08	26,805.26	9,972,293.02	5,484,381.12	10,032,283.10	5,511,186.38
Other	953,586,305.74	926,259,864.82	-	-	953,586,305.74	926,259,864.82
	<u>\$ 8,031,428,175.65</u>	<u>\$ 7,952,814,120.96</u>	<u>\$ 1,849,713,105.86</u>	<u>\$ 1,769,049,964.53</u>	<u>\$ 9,881,141,281.51</u>	<u>\$ 9,721,864,085.49</u>
Expenses:						
Education	\$ 38,576,887.39	\$ 38,895,631.31	\$ -	\$ -	\$ 38,576,887.39	\$ 38,895,631.31
Health and Welfare	7,942,971,466.58	7,692,868,353.91	2,092,456,636.03	1,850,125,372.84	10,035,428,102.61	9,542,993,726.75
Contribution to State's General Fund	5,670,258.87	16,948,131.78	-	-	5,670,258.87	16,948,131.78
	<u>\$ 7,987,218,612.84</u>	<u>\$ 7,748,712,117.00</u>	<u>\$ 2,092,456,636.03</u>	<u>\$ 1,850,125,372.84</u>	<u>\$ 10,079,675,248.87</u>	<u>\$ 9,598,837,489.84</u>
Change in Net Assets	\$ 44,209,562.81	\$ 204,102,003.96	\$ (242,743,530.17)	\$ (81,075,408.31)	\$ (198,533,967.36)	\$ 123,026,595.65
Net Assets, July 1	(43,427,330.32)	(247,529,334.28)	346,493,318.99	427,568,727.30	303,065,988.67	180,039,393.02
Net Assets, June 30	<u>\$ 782,232.49</u>	<u>\$ (43,427,330.32)</u>	<u>\$ 103,749,788.82</u>	<u>\$ 346,493,318.99</u>	<u>\$ 104,532,021.31</u>	<u>\$ 303,065,988.67</u>

Department of Community Health

MANAGEMENT'S DISCUSSION AND ANALYSIS

JUNE 30, 2005

Financial Analysis of the Government's Funds

As noted earlier, the Department uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental Fund. The focus of the Department's *Governmental Fund* is to provide information on near-term inflows, outflows, and balances of *spendable* resources. Such information is useful in assessing the Department's financing requirements. In particular, *unreserved fund balance* may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As of the end of the current fiscal year, the Governmental Fund of the Department had a fund balance of \$15,958,593.99. This amount differs from the net asset amount in Governmental Funds of \$782,232.49 due to different accounting treatment for capital assets and long-term liabilities. This difference is further explained in the financial statements.

The positive fund balance represents the fact that current financial resources outweigh current financial obligations.

Other receivables as of June 30, 2005 decreased by \$84,843,491.02 from that of the previous year. The decrease is due to continued recoupment of interim payments that were made to providers as a result of the initial inability of the new software system to pay claims appropriately as discussed earlier.

Benefits payable as of June 30, 2005 increased by approximately \$56,100,000.00 from that of the previous year. As mentioned previously, this is a reflection of the growth in net payments.

Other matters within the analysis of the Governmental Fund's activities include:

- The overall revenues of the fund increased by 0.99 percent from that of the previous year while the overall expenditures increased by approximately three percent.
- The fund balance increased by over \$30 million primarily due to higher than anticipated drug rebates as well as hospital cost settlements.
- Total health and welfare expenditures increased from \$7,692,049,642.58 from the year ended June 30, 2004 to \$7,942,888,539.57 for the year ended June 30, 2005.

Due to the significance of the dollars related to health and welfare expenditures, a more detailed discussion follows concerning the primary Medicaid and PeachCare for Kids cost drivers: utilization, enrollment, and payments to providers.

Department of Community Health

MANAGEMENT'S DISCUSSION AND ANALYSIS

JUNE 30, 2005

Georgia Fiscal Year 2005 Cost Drivers Summary

The Change in Claims Payment Processing appears to have had a greater impact on the fiscal year 2005 trends than noted in fiscal year 2004. With the Department's projected trends decreasing from 12.6 percent in fiscal year 2004 to 6.4 percent in fiscal year 2005, management wanted to further highlight the key contributors to this significant decline in the rate of increase. While the Department has made several cost containment efforts to reduce the rate of growth, there are a few claims payment processes that may have had an impact on the data extracted from ACS used to update the fiscal year 2005 trends.

1. Advanced payments, adjustments and recoupments. During the Medicaid Management Information System ("MMIS") implementation, the claims payment process was impacted by temporary payment processes that may have impacted actual net payments for this time period. Advanced payments were made to providers that were not associated with actual claims at the time of payments and therefore were not included in the claims extract sent to the Department's decision support vendor (Medstat Group). Manual adjustments and recoupments were made to correct for any over/under payments from this process.
2. Mass reprocessing of claims. Beginning in September 2004, the Department and ACS began reprocessing claims originally paid from July 1, 2003 to June 30, 2004. These reprocessed claims also impact current trends. In an effort to make updates to system edits and other changes, ACS has undergone a massive reprocessing effort of previously paid claims. This effort has impacted the final net payments related to the trends the Department is experiencing.

Below is a table that highlights those categories of service ("COS") that experienced the most significant change in trend rates in fiscal year 2005 compared to fiscal year 2004. While the Department has made several program changes geared at positively impacting this trend, it is likely that for some categories, such as Outpatient Hospital and Nursing Home, the trends may be understated.

NET PAYMENTS (INCLUDES MEDICARE CROSSOVER CLAIMS) (in millions)						
	Fiscal Year 2003	Fiscal Year 2004	Fiscal Year 2005 *	Fiscal Years 2003-2004 % Change	Fiscal Years 2004-2005 % Change	Point Drop In Trend
Total (in millions)	\$ 5,194.0	\$ 5,849.1	\$ 6,222.1	12.6%	6.4%	-6.2
Mental Retardation Waiver Program	\$ 142.4	\$ 145.3	\$ 168.0	2.0%	15.6%	13.6
Outpatient Mental	\$ 98.6	\$ 98.3	\$ 110.0	-0.3%	11.9%	12.2
Dental	\$ 119.9	\$ 136.3	\$ 159.7	13.7%	17.2%	3.5
Inpatient	\$ 1,135.4	\$ 1,259.1	\$ 1,385.4	10.9%	10.0%	-0.9
Physician	\$ 572.3	\$ 614.1	\$ 643.8	7.3%	4.8%	-2.5
Outpatient	\$ 531.2	\$ 609.8	\$ 629.1	14.8%	3.2%	-11.6
Prescription Drugs	\$ 898.7	\$ 1,063.2	\$ 1,120.9	18.3%	5.4%	-12.9
Nursing Home	\$ 814.9	\$ 967.2	\$ 989.7	18.7%	2.3%	-16.4
Residential Therapy	\$ 88.5	\$ 110.6	\$ 96.2	25.0%	-13.0%	-38.0
* Fiscal year 2005 considered projected pending the receipt of claims incurred but not reported as of the date this table was prepared.						

Department of Community Health

MANAGEMENT'S DISCUSSION AND ANALYSIS

JUNE 30, 2005

3. Reprocessed claims for previously denied claims. Claims that have been reprocessed for previously denied claims are included in the Decision Support System ("DSS") paid claims table. These claims have been voided and adjusted for payment. The void records for these claims create overstated negative service counts in the database. Because the negative service counts are not associated with a previously paid claim, the services (and associated utilization) are understated.
4. Utilization cost driver. The following table represents a gross end utilization by major category of service.

Utilization Trends by Service Type						
Utilization Measures	Fiscal	Fiscal	Fiscal Year	Fiscal Years	Fiscal Years	Point Drop
	2003	2004	2005 *	2003-2004 % Change	2004-2005 % Change	In Trend
Prescriptions/Member	15.2	15.8	15.7	3.90%	-0.60%	-4.6
Admits/1000	192.2	201.9	205.4	5.00%	1.70%	-3.3
Outpatient Services/1000	10,712	12,414	12,311	15.90%	-0.80%	-16.7
Physician Services/1000*	6,807	8,004	7,862	17.60%	-1.80%	-19.4
Nursing Home Days/1000	8,681	8,141	7,994	-6.20%	-1.80%	4.4

* Used fiscal year 2005 report statistics for physician services.

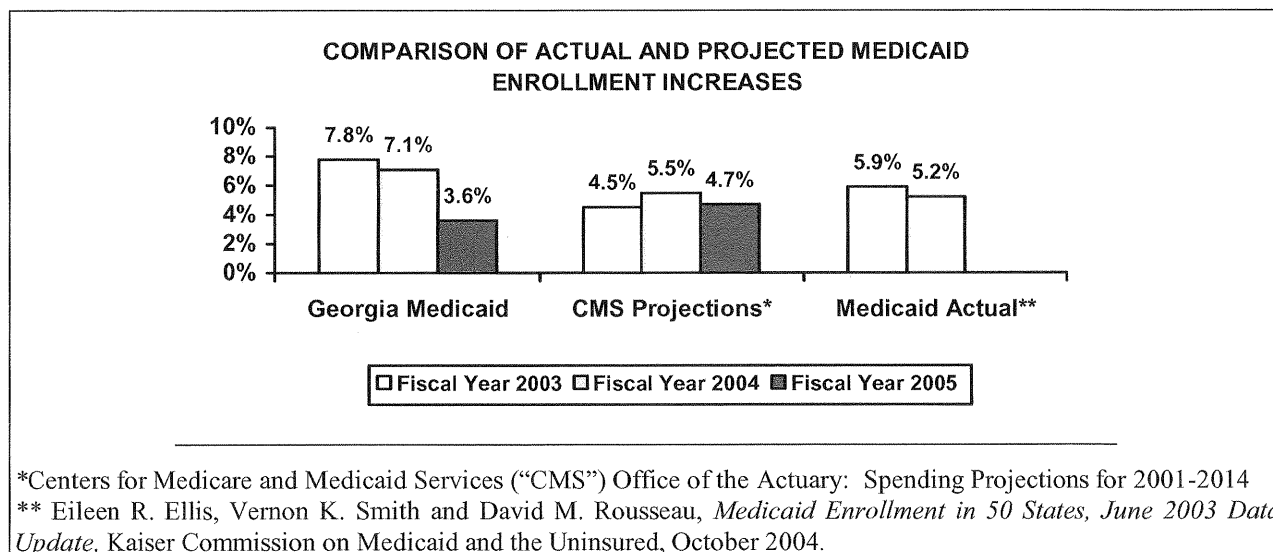
5. Prescription Drug Trend. A Significant Decrease in Prescription Drug Trend has had a favorable impact on the Department's reduced fiscal year 2005 trend. There are several factors that have contributed to this trend. Pharmacy claims are received directly from the Department's pharmacy benefit manager (Express Scripts, Inc.) and were not impacted by the claims reprocessing issues noted above. Pharmacy costs contributed \$51.1 million to total fiscal year 2005 trends compared to \$149 million towards fiscal year 2004 trends. The following factors contributed to the decreased rate of the prescription drug growth:
 - a) An increase in the rate of use for less expensive generic drugs. The Department expects one-time savings reductions this year due to this increase.
 - b) Changes in utilization for highly prescribed drugs such as Vioxx.
 - c) Decrease in overall pharmacy utilization.
6. Enrollment Trend. Increased Medicaid Enrollment continues to be a major driver of fiscal year 2005 cost increases, although with a less significant impact than seen in previous years. Georgia's average enrollment increased 3.6 percent in fiscal year 2005, compared to 7.1 percent in fiscal year 2004. For the first time in recent years, this growth is lower than the projected Medicaid enrollment growth of 4.7 percent for fiscal year 2005. Enrollment

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projections have been higher than actual State experience for the last several years; however, this year the State's trend is lower.



Georgia's fiscal year 2005 enrollment growth is driven almost entirely by increases in Low Income Families and Children including Right from the Start Medicaid ("RSM"). While the rate of fiscal year 2005 enrollment growth is slowing, this population remains more sensitive to the State's economic picture. As Georgia's low income enrollment has been growing, its aged and disabled enrollment has continued to decline due to changes in eligibility requirements.

AID CATEGORY GROUP ENROLLMENT				
	Fiscal Year 2004	Fiscal Year 2005		
Aid Category Group	Average	Average*	Change	% Change
Average Monthly Enrollment				
13 Aged with and without Medicare	59,976	58,543	-1,434	-2.4%
14 Blind/Disabled with and without Medicare	206,874	203,910	-2,964	-1.4%
5 – Qualified Medicare Beneficiaries	47,024	50,278	3,254	6.9%
6 – Low Income Medicaid (TANF)	384,912	406,416	21,504	5.6%
7 – Right from the Start Medicaid Child	508,952	534,465	25,513	5.0%
8 – Right from the Start Medicaid Adult	59,237	59,377	139	0.2%
9 – Refugee	778	913	135	17.4%
All Other	15,698	16,762	1,064	6.8%
Annual Enrollment	1,283,451	1,330,664	47,211	3.6%
*Enrollment for fiscal year 2005 through May 2005. Excludes SLMBs and QMBs. Allowing for lagged eligibility, the average enrollment for fiscal year 2005 is 1,285,966 leading to a 4.0 percent trend.				

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Financial Analysis of Proprietary Funds

Proprietary Fund – Enterprise Fund. The Department's Enterprise Fund provides the same type of information found in the department-wide financial statements. As stated earlier, the Department uses an Enterprise Fund to account for its State Health Benefit Plan (the "Plan") financial activities. This fund records activity on the full-accrual basis of accounting and financial reporting.

Total assets for the Plan decreased by 39.08 percent. The majority of this decrease was due to an 86.7 percent decrease in cash and a 14 percent decrease in investments during the fiscal year 2005.

On the liability side of the statement of net assets, there was a 10.71 percent increase in liabilities overall. The largest component of the liabilities, benefits payable, increased by 9.4 percent from \$154,822,000.00 at the end of fiscal year 2004 to \$169,380,000.00 at the end of fiscal year 2005.

Net assets decreased during the year by \$242,743,530.17 resulting in a final net asset amount at June 30, 2005 of \$103,749,788.82. This decrease is the result of current year operating expenses exceeding current year revenues. This was a planned use of the fiscal year 2004 Proprietary Fund balance in lieu of additional state appropriations to support proprietary revenue via employer contribution increases.

Premiums collected from participants increased by 4.4 percent (or \$76,218,521.43) from that of fiscal year 2004 due to an increased enrollment and an increase in employee premiums. The Enterprise Fund also received state funding in the amount of \$33,956,708.00. Total operating revenues increased from fiscal year 2004 to fiscal year 2005 by 4.3 percent; however, overall expenditures for this fund increased 13.1 percent.

The fund's statement of cash flows reflected negative cash flows from operations - meaning less cash was provided from operations than used in operations. Net cash used by operating activities amounted to \$235,610,503.13. The negative cash flows are primarily due to a higher percentage increase in claims expense over a lower percentage increase in premiums.

The Plan incurred expense growth in benefits of 11 percent during the fiscal year 2005 plan year. Per member per year ("PMPY") growth contributed 10% to the overall growth and membership contributed the remaining one percent.

Inpatient Hospital

Expenditures in Inpatient Hospital grew by 13 percent in fiscal year 2005. This increase was driven by utilization. This is apparent when comparing Admits/1000 and Days/1000. Admits/1000 increased by six percent while Days/1000 only increased by one percent. This shows that the average length of stay per admission remained relatively flat while the number of admissions increased. Therefore, there were more people being admitted to the hospital in fiscal

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year 2005 than in fiscal year 2004. So the number of admissions, not the length of stay, was driving the 13 percent increase in expenditures in Inpatient Hospital.

Outpatient Hospital

Outpatient Hospital experienced expenditure growth of 14 percent in fiscal year 2005. Similar to Inpatient Hospital, utilization is driving expenditure growth in this area. Office Visits/1000 increased by four percent and ER Visits/1000 increased seven percent. There were also utilization increases in Lab Services/1000 (eight percent) and Radiology Services/1000 (eight percent). All of these areas contributed to the 14 percent growth in Outpatient Hospital.

Other Areas

The remaining areas of service grew by eight percent in fiscal year 2005.

Per Member per Year

When comparing health plans, Cigna had the largest growth in PMPY cost. Cigna's PMPY cost increased by 25 percent. Cigna's expenditures grew by 54 percent while its membership only grew by 23 percent. Expenditure growth outpaced membership growth which resulted in a higher PMPY cost for Cigna. A summary of PMPY growth for all health plans is as follows:

<u>Health Plan</u>	<u>PMPY % Growth</u>
PPO	16%
Indemnity	6%
United HealthCare HMO	10%
Cigna HMO	25%

Budgetary Highlights

The most significant differences between the original fiscal year 2005 and the final amended budget relate to the increase in funding for Medicaid benefits by using prior year funds of \$104,363,159 to fully fund fiscal year 2005 Medicaid benefits and operational deficits.

Fiscal Year 2005 Base Appropriations - House Bill 1181

- Increase in State funds for Medicaid cash obligations = \$368,411,761
- Increase in State funds for PeachCare benefits to fund projected cost of claims = \$29,516,402
- Increase in State funds in accordance with House Bill 526 to reflect nursing home provider fees and increase in funds for nursing home providers = \$16,852,640
- Decrease in State funds for Medicaid reductions = \$82,737,080
- Decrease in State funds for PeachCare reductions = \$13,805,833

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Capital Assets Administration

The Department's capital assets for its *governmental activities* and *business-type activities* as of June 30, 2005, totaled \$738,262.26 (net of \$787,407.48 in accumulated depreciation). This investment in capital assets includes equipment, furniture and fixtures. For additional information on capital assets, see note 4.

Debt Administration

As of June 30, 2005, the outstanding long-term obligations to a contractor including interest totaled \$14,055,614.00 of which the total amount is due within one year, payable in quarterly installments of \$3,513,903.50. In accordance with accounting principles generally accepted in the United States of America, the Department has imputed interest. The Department's total obligation of \$14,055,614.00 is presented net of \$186,329.34 of interest. The present value amount of \$13,869,284.66 is based on an imputed interest rate of 2.14 percent, the State's estimated cost of funds rate. For additional information on debt administration, see note 6.

Currently Known Conditions Affecting Future Operations

The Department's fiscal year 2006 State appropriated budget increased 7.1 percent over fiscal year 2005.

The Department began managing its resources through a Prioritized Program Budget ("PPB") process beginning with the fiscal year 2006 budget. Instead of focusing on the functions of the agency, the budget now identifies and analyzes programs that support agency business plans. For fiscal year 2006, the General Assembly of Georgia expanded the PPB process through the Appropriations Act by appropriating funds by programs instead of by object class and functional unit. Because of this change in the Appropriations Act, the Department will now be required to record and monitor expenditures by program and object class. While the Department will continue to monitor expenditures by object class, they are no longer recognized in the Appropriations Act.

On April 20, 2005, the Department received official notice from the CMS that the MMIS met the certification requirements specified in the State Medicaid Manual and was operational on August 1, 2003. As a result of this certification, the State may claim federal financial participation at the 75 percent rate of reimbursement for the operational cost of its MMIS from the effective date of August 1, 2003. The State will claim additional federal funds in fiscal year 2006.

Beginning in April 2006, the Department will utilize risk-based managed care to provide benefits to members who are in the Low Income Medicaid, Right from the Start Medicaid, and PeachCare for Kids eligibility categories. The Department has contracted with three CMOs to serve over 1,000,000 members in these groups. Approximately 40 percent of current Medicaid benefits will be paid via capitated payments to the CMOs once the program is fully operational in December 2006. While the Department will help members choose which CMO they would like to

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enroll in, the CMO will be responsible for providing access to care via their own provider networks and making payments to their providers who render care.

In October 2005, the Department entered into a contractual agreement with two disease management ("DM") vendors to help manage the care of approximately 100,000 members who are in the Aged, Blind, or Disabled Medicaid eligibility categories and who do not qualify for nursing home services. The Department will pay the DM vendors a Per Member Per Month administrative fee to provide case management services. The vendor contracts are risk-based, and vendors who do not meet cost avoidance targets will be required to return up to 100 percent of their administrative payments at the end of an annual evaluation period. The refund of administrative fees to the Department will be pro-rated based on the level of cost avoidance not achieved.

Requests for Information

This financial report is designed to provide a general overview of the Department of Community Health's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Chief Financial Officer, Department of Community Health, 2 Peachtree Street, N.W., Atlanta, Georgia 30303-3159.